QUARTERLY NEWSLETTER • **2ND QUARTER 2019**

PRAETORIAN GUARD

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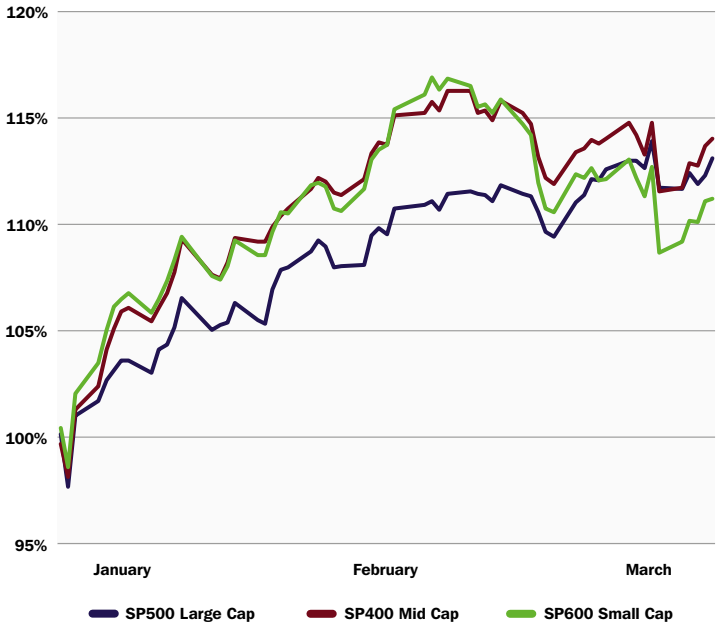
FIRST QUARTER 2019 MARKET COMMENTARY

By **Richard A. Hewitt**

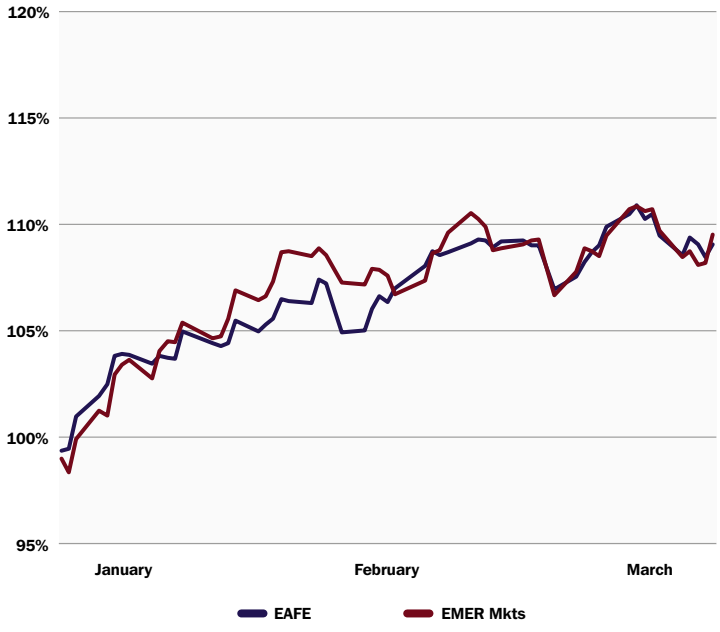
All stock markets started off the year on a strong positive path for January and February with some consolidation during March. Overall, this quarter we see double digit gains for U.S. large, mid and small cap equities and slightly less than that for International Developed and Emerging Markets.

U.S. Equity Market Performance Q1 2019



Source: Yahoo! Finance

International Equity Market Performance Q1 2019



Source: Yahoo! Finance

The first week of March marks the start of the current 10 year bull market run (depending on if we choose the Dow Jones 30 Index or the S&P 500) which hit their Great Recession lows in 2009 on March 4th and 9th respectively. What lessons have we learned in this past decade? I believe the following should be on any investor's list: *(continued on pg. 4)*

QUALIFIED OPPORTUNITY ZONES (QOZ)

By **Marc A. Wehmeyer**

In recent months we have fielded multiple questions regarding investments in Qualified Opportunity Zones (QOZs) which were newly created as part of the 2017 Tax Cuts and Jobs Act. The purpose of designating QOZs is to support economic development and job creation in distressed American communities. To encourage investments in QOZs, the federal government is allowing taxpayers to defer realized capital gains by investing those gains in QOZ property.

SINCE QOZS ARE A BRAND-NEW ENTITY, THE FUNDS BEING FORMED TO INVEST IN THEM WILL HAVE NO PERFORMANCE HISTORY FOR INVESTORS TO CONSIDER PRIOR TO MAKING THE DECISION TO INVEST.

Since taxes on capital gains are realized only upon the sale of taxable property, techniques to defer them can provide a powerful incentive. Investors holding a highly appreciated asset may be reluctant to sell it because they don't want to realize a taxable gain, even if selling the asset reduces the risk of continuing to hold a concentrated position or would simplify their life and potentially make them happier.

Investors in QOZs can defer taxes owed on capital gains which are reinvested in a Qualified Opportunity Fund (QOF) until December 31, 2026 or until the investment in the QOF is sold or exchanged, whichever is earlier. A QOF is an investment vehicle in which at least 90% of the fund's capital in invested in QOZs.

For example, if you sold a highly appreciated stock position or rental property, you could defer the realized capital gains by investing the gain in a QOF within 180 days beginning on the date of the sale of the previous asset. You don't have to reinvest the principal of the previous asset. In addition to the deferral benefit, a portion of the deferred gains may be forgiven if the QOZ investment is held long enough. After five years, 10% of the deferred gain will be forgiven through a cost basis adjustment, and after seven years an additional 5% of the originally deferred gain will be forgiven for a total of 15%. Furthermore, if the QOZ property is held for at least 10 years, there will be no capital gains realized on the QOZ investment itself. There is no limit on the amount of gains you can defer through QOZ investments.

The prospect of the tax benefits associated with QOZ investments can obscure the potential risks associated with them. Since QOZs are a brand-new entity, the funds being formed to invest in them will have no performance history for investors to consider prior to making the decision to invest. It is possible that a poorly conceived and managed QOF could experience investment losses that exceed the potential tax savings of the investment. Also, in order to benefit from the maximum available tax savings, an investor must lock themselves into a QOF for an extended period of time reducing the overall liquidity of their assets.

If an investor still wants to defer capital gains and doesn't need to use an asset to support financial goals during their lifetime, the surefire way to eliminate capital gains (at least under current law) is to let the asset pass at death when it would receive a stepped-up basis to the beneficiary.

In general, we don't believe it ever makes sense to let the "tax tail" wag the dog. Tax considerations, while important, are just one part of any financial decision. If you think investing in a QOF could make sense in your situation, we encourage you to reach out to us.

PRESIDENT'S COMMENTARY

As U.S. economic data has been reported in the first quarter, there are several positives for us to focus on. Unemployment continues to be near or at historical lows and is beginning to translate into wage growth gains.

U.S. energy output continues to expand and should run above 12 million barrels per day for 2019 and even higher in 2020. This has direct benefits for industry, consumers and the transportation sector as it helps to hold down inflation, giving the Federal Reserve one less concern that could generate an interest rate hike. It also allows for strong sanctions on Iran and Venezuela without disrupting international oil markets.

A U.S.-China trade deal reportedly is closer to agreement than it was 90 days ago. This is the most important macroeconomic issue to get resolved to keep the U.S. growth rate at or near the 3% level.

We have entered the 2020 election season—will the last Democratic Senator to declare his/her candidacy please turn off the lights?

POLITICAL AND ECONOMIC OUTLOOK

By **Richard A. Hewitt**

Long time readers know I don't hesitate to read the tea leaves and attempt to discern how that might affect our clients. It is too soon to handicap any of the declared presidential candidates, but it is easy to identify those with no chance of getting out of Iowa in a politically viable state (see Inslee, Buttigieg, Castro, Delaney, Gabbard).

BREXIT—POLITICAL DIVORCE IS PROVING MUCH HARDER THAN IMAGINED IN THE UK. I PREDICT WE'LL SEE A "NO DEAL" EXIT AFTER THE EXTENSION OF THE MARCH 29TH DEADLINE.

The current Washington DC environment is such that virtually nothing will get accomplished this year—we can set our sights low: we will have a debt ceiling suspension that allows for continued Federal borrowing. At best, half of the FY 2020 appropriations bills will be funded by September 30, 2019 and many programs will enter 2020 operating under a continuing resolution (CR) environment into the presidential primary season.

There will be no relief from the $10,000 SALT (State & Local Tax) deduction limitation on Federal Income taxes—if you are in one of the states where you experienced this pain upon filing your 2018 return, make sure to adjust your withholding or estimated tax payments as this is here to stay through 2025.

The U.S.-China trade deal will get signed formally by April 30, 2019—it will be a net benefit to the U.S., but not the "greatest deal of all time." The market impact will be positive and remove a large degree of uncertainty for the remainder of the year.

BREXIT—political divorce is proving much harder than imagined in the UK. I predict we'll see a "no deal" exit after the extension of the March 29th deadline. Negatives include the need for the UK to negotiate multiple treaties and arrangements over the next several years. Positive is that no other nation will voluntarily attempt to leave the EU again.

FIRST QUARTER 2019 MARKET COMMENTARY (CONTINUED)

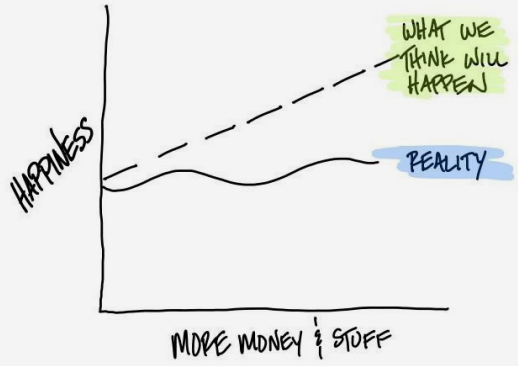
(continued from pg. 1)

#1: For some, your actual risk tolerance is a function of two things: the market's direction the last few weeks combined with the last report or update you read/heard on today's date. However, it should be based on an unemotional (as possible) assessment of the risk you need to accept to accomplish your goals contrasted against what shorter term decline in the market you can stomach (without panicking). **Lesson:** be realistic, and on the downside, know that panicking will make attainment of your goals much harder.

#2: Financial talking heads are paid to fill air time and you are less likely to get called back unless you make a news worthy call. So… the incentive is to predict boldly and hope no one remembers. Tracking those predictions is entertaining because the "missed the mark" rate is near 100%. **Lesson:** you know your situation and your assessment of your personal economy much better than any TV personality. Listen to your head and use the OFF button on your TV remote!

#3: The U.S. economy remains the most amazing wealth creation vehicle the world has ever seen. It is not perfect, seldom pretty and fortunately most times not very submissive to political demands. We attempt to control it to serve our political class at our own risk—the business leader is a better judge of where to invest profits than the politician because the price of being wrong is being out of business.

HAPPINESS



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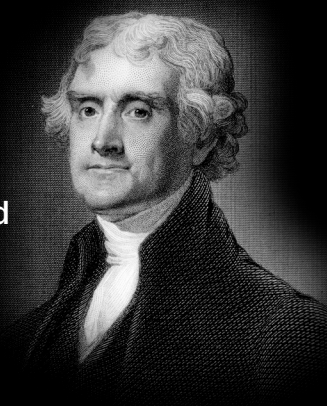
CLOSING THOUGHT

"Would it not be better to simplify the system of taxation rather than to spread it over such a variety of subjects and pass through so many new hands?"



—Thomas Jefferson

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